MANUFACTURERS HANOVER

B5350-3A

Economic Report

June 1991

Commentary on Pertinent Economic Issues

Irwin L. Kellner
Chief Economist

Manufacturers Hanover Economics Department 17/270

The Worst Is Over

Not long ago, the National Bureau of Economic Research, the official arbiter of the business cycle, determined that America's ninth postwar recession got underway last August. If it continued through the end of last month, it would be ten months long—no worse than six of its eight postwar predecessors, as far as length is concerned. It is milder than average in most other respects as well. For there are a growing number of signs which suggest that the worst may be over, and that our tenth postwar expansion may be close at hand.

As usual, there are some who would dispute the view that the end of Western Civilization as we know it has once again been postponed. By and large, they tend to be those people who are experiencing economic uncertainty for the first time in their adult memory. And there are many of them, in view of the length of the expansion which preceded this recession. By setting the business cycle peak as last July, the NBER declared that the 1982-90 expansion lasted a whopping 92 months. This was far and away the longest uninterrupted stretch of growth for the U.S. economy in peacetime. It was more than twice as long as the postwar average—and was second only to the 106-month expansion that included the Vietnam War.

Darkest Before Dawn

Among the naysayers are those nabobs of negativism from the business community. A recent meeting of the prestigious Business Council found most corporate executives in strong disagreement with their economists, who are forecasting an early end to this recession. You can't blame many businessmen, I suppose, in view of their own dreary circumstances. Government figures show that new orders for durable goods topped out last autumn, and by March were running a hefty 15 percent below their peaks. Unfilled orders, consequently, have fallen two percent—and are down even more, if you take out transportation equipment, mainly aircraft, which takes a long time to build.

Speaking of transportation, anyone remotely connected with the automobile industry can't be a happy camper, these days. New domestic car sales in April and May ran at the lowest rate in 8½ years—when the economy was in the last recession. A number of factors have been blamed for this seeming lack of buying interest in new cars, but the most important, it seems to me, is the question of affordability.

For over ten years, the automakers have been boosting car prices faster than the increase in their customers' incomes. In 1980, the typical car cost the equivalent of 18 weeks of the average family's income; by last year it was nearly 24 weeks—and this is with more jobs per family! To offset this, car buyers have been encouraged to borrow for longer periods to enable them to bring their monthly payments back into line with their incomes—but this has had the effect of keeping people out of the market for a new car that much longer.

With autos chugging along in low gear, it would be tough to jump-start the economy even under the best of circumstances. But this is far from an ideal gestation period to bring forth an economic recovery because another key industry, construction, is languishing as well. The building boom of the 1980s has combined with the downsizing of business staffing needs of the 1990s to produce a glut of vacant space. The office vacancy rate today is more than 17 percent compared with only four percent ten years ago, while nearly 23 percent of factory space is currently unused, versus 15 percent 2¼ years ago. Many regions also report excess space in shopping centers, warehouses, and hotels. To make matters worse, even where there might be an opportunity to develop a piece of property, financing is very difficult to come by, as lenders try to cope with the two-way squeeze caused by the Tax Reform Act of 1986 (which depressed real estate values), and tightened regulatory standards regarding bank capital ratios and the loan examination process (which has inhibited lending).

When consumers look around, they are not thrilled, either. While various surveys of people's moods show a nice rise in confidence from January's 16-year low, it is mostly due to rosier expectations for the future—not because of any sudden improvement in their current financial situation. Payroll employment is down by 1⅔

Copyright 1991 Manufacturers Hanover Corporation 270 Park Avenue, New York, NY 10017

million from its high point last June, the number of reported jobless is up by nearly 26 percent, while the unemployment rate in March hit its highest point in 4½ years. Because a larger than usual number of unemployed have come from the better-paid, white-collar ranks, personal incomes adjusted for inflation in the first eight months of this recession alone were down by more than in any previous full-term recession in the past 38 years except for the 1973-75 downturn, which in many respects was the worst since the 1930s.

Years of trying to keep up with rising prices and higher taxes have depleted many families' savings, causing them to go heavily into debt. The savings rate has fallen to one of its lowest levels in the postwar era, while people owe more, relative to their take-home pay, than they ever have before. It hasn't helped matters that the value of the average family's biggest asset—its home—has fallen significantly over the past three years.

On the other hand, the drop in home prices has also produced buying interest. Sales of both new and existing one-family homes bottomed out in January, seasonally adjusted, while housing starts are well above their January lows. People are evidently responding to what they rightly believe are the best buys in quite some time. Based on a ratio of average selling prices to family incomes alone, new-home affordability is the greatest it's been in at least three years; include today's lower mortgage rates and the comparison stretches back to the early 1980s.

Help From Housing

This pickup in housing activity should not be underestimated, when it comes to helping the economy emerge from a recession. Sales of new houses, of course, will increase the demand for all kinds of materials that go into the construction of a home—not to mention for the skilled labor necessary to build the house. This adds to business and employee earnings, as you can imagine, even before a family moves in. Once it does, it usually furnishes, so additional spending on furniture, fixtures, home appliances, wallpaper and carpeting or flooring takes place. These latter expenditures will also occur when an existing home is purchased, although maybe at a slower pace, since this kind of home has already been furnished. Regardless, home sales do get people back into the buying habit, and once consumers have returned to the stores, it doesn't take much to trigger additional spending, such as on electronics, apparel, etc.

The latest figures show this may already be underway. Retail sales at general merchandisers have risen three percent in the past four months, after falling 2¾ percent during the preceding four. In April, merchants selling building materials, garden supplies and housewares reported a healthy 3½ percent jump in sales, while furniture and other home equipment posted an increase of nearly two percent. Retailers of apparel saw their sales rise by over two percent, while restaurants rung up a half-point gain.

If consumers keep their wallets open, merchants and other businessmen will soon find it necessary to stop trimming their staffs, and start adding. At the manufacturing level, this may already have begun. The factory workweek—a leading indicator of future hiring activity—turned up in April after three consecutive months of decline, while payroll employment fell at a much slower pace than the average of the previous six months. New claims for unemployment benefits were 100,000 fewer at the start of last month than they were in late March, while the percentage of nonfarm industries adding jobs in April was the highest in more than six months. As long as these trends continue, both real incomes and people's confidence in their current situation will start rising, reinforcing the upturn in retail sales, thus in aggregate economic activity.

The nation's purchasing managers already sniff improvement in the air. Their index covering the industrial side of the economy hit bottom in January, and has been rising ever since. It has finally showed up in the output of the nation's factories, mines and utilities, which rose in April, after falling nonstop during the previous six months. In particular, gains were reported in business equipment and in goods for export. Nevertheless, production schedules are being kept below the pace of sales, since business inventories are still sliding.

Keeping inventories lean is a good idea when sales are soft and financing is hard to come by. But sales have firmed, suggesting some re-stocking might be necessary. This, of course, would probably involve an increase in financing, which should now be more available, given the recent increase in bank reserves and in the money supply as part of the Federal Reserve's efforts to resuscitate the economy. The Fed is currently pumping out reserves at the fastest pace in four years, while the money supply is expanding by the most in a year. Since business demand for short-term credit remains weak, this had led to a 2½ point drop in the Federal funds rate since last summer alone, allowing the banks to bring their prime lending rates down to the lowest level in three years.

June 1991
MH FORECAST OF GROSS NATIONAL PRODUCT
(Seasonally Adjusted Annual Rates)
In $ Billions

	< Actual						Projected >					
	1990				YEAR 1990		1991				YEAR 1991	
	1	2	3	4	LEVEL	% CH	1	2	3	4	LEVEL	% CH
Gross National Product	5375.4	5443.3	5514.6	5527.3	5465.1	5.1	5562.3	5597.0	5658.9	5716.9	5633.7	3.1
GNP: $82	4150.6	4155.1	4170.0	4153.4	4157.3	1.0	4123.9	4119.1	4135.6	4154.7	4133.3	–0.6
% Change, Annual Rates	1.7	0.4	1.4	–1.6	1.0		–2.8	–0.5	1.6	1.9	–0.6	
Consumption $82	2677.3	2678.8	2696.8	2673.6	2681.6	0.9	2664.1	2669.8	2681.3	2699.0	2678.5	–0.1
Durables $82	437.6	426.8	429.5	415.6	427.4	–0.1	403.9	401.1	403.2	407.7	403.9	–5.5
Non-Durables $82	915.6	911.2	916.4	901.2	911.1	–1.0	894.6	900.0	904.9	912.8	903.1	–0.9
Services $82	1324.2	1340.9	1350.8	1356.7	1343.2	2.6	1365.5	1368.7	1373.3	1378.5	1371.5	2.1
Investment $82	700.7	700.7	697.0	656.3	688.7	–3.9	630.1	629.3	632.0	634.7	631.5	–8.3
Non-Residential $82	514.6	508.4	519.3	519.4	515.4	1.8	499.6	483.1	477.9	473.9	483.6	–6.2
Producers Durable Equip. $82	390.8	387.5	397.0	403.1	394.6	2.8	386.5	376.7	375.4	373.9	378.1	–4.2
Structures $82	123.8	120.9	122.4	116.4	120.9	–1.2	113.0	106.4	102.5	100.1	105.5	–12.7
Residential $82	188.3	182.8	173.0	163.3	176.8	–5.4	151.2	151.6	153.0	152.7	152.1	–14.0
Inventory Changes $82	–2.2	9.5	4.7	–26.4	–3.6		–20.7	–5.4	1.1	8.1	–4.2	
Net Exports $82	–35.4	–44.6	–46.5	–8.8	–33.8		2.2	–7.6	–8.8	–9.7	–6.0	
Exports $82	628.1	620.1	630.5	647.2	631.5	6.4	646.5	642.0	639.9	640.0	642.1	1.7
Imports $82	663.5	664.7	677.0	656.0	665.3	2.8	644.3	649.6	648.6	649.6	648.0	–2.6
Government Purchases $82	807.9	820.2	822.7	832.3	820.8	2.8	827.5	827.6	831.1	830.6	829.2	1.0
Federal Defense $82	254.4	256.5	258.2	265.7	258.7	0.9	265.2	267.4	270.8	270.2	268.4	3.7
Federal Civilian $82	78.6	89.4	87.8	84.2	85.0	8.1	81.6	80.2	80.2	80.1	80.5	–5.2
State & Local $82	475.0	474.3	476.7	482.4	477.1	3.0	480.7	480.0	480.0	480.3	480.3	0.7
Final Sales: $82	4152.8	4145.6	4165.3	4179.8	4169.9	1.6	4144.6	4124.5	4134.5	4146.5	4137.5	–0.6
% Change, Annual Rates	3.8	–0.7	1.9	1.4	1.6		–3.3	–1.9	1.0	1.2	–0.6	
Domestic Demand: $82	4186.0	4199.7	4216.5	4162.2	4191.1	0.5	4121.7	4126.7	4144.4	4164.4	4139.3	–1.2
% Change, Annual Rates	0.5	1.3	1.6	–5.1	0.5		–3.8	0.5	1.7	1.9	–1.2	
GNP Price Index (1982 = 100)	129.5	131.0	132.2	133.1	131.5	4.1	134.9	135.9	136.8	137.6	136.3	3.7
% Change, Annual Rates	4.8	4.7	3.7	2.8	4.1		5.5	2.9	2.8	2.3	3.7	
Consumer Price Index (82-84 = 100)	128.2	129.4	131.6	133.8	130.7	5.4	135.0	136.2	137.2	138.2	136.6	4.5
% Change, Annual Rates	7.5	3.8	6.9	7.0	5.4		3.5	3.7	3.0	2.9	4.5	
Total Personal Income	4562.8	4622.2	4678.5	4718.5	4645.5	6.0	4735.2	4742.8	4784.3	4833.5	4773.9	2.8
Disposable Personal Income	3887.7	3925.7	3969.1	4001.9	3946.1	5.9	4016.9	4023.7	4056.8	4096.5	4048.5	2.6
Savings Rate	4.9	5.0	4.2	4.2	4.6		4.1	3.5	3.2	3.0	3.5	
Unemployment Rate	5.3	5.3	5.6	5.9	5.5		6.5	7.0	7.2	7.2	7.0	
Indus. Production (1987 = 100)	108.3	109.4	110.4	108.5	109.2	1.0	105.9	104.6	104.8	105.7	105.2	–3.6
Housing Starts (000)	1454.3	1203.7	1130.7	1042.3	1207.8	–12.9	913.7	984.8	1016.2	1116.4	1007.8	–16.6
Domestic Auto Sales (000)	7014.7	6798.0	7211.3	6590.0	6903.5	–2.6	6150.0	5807.4	6064.4	6198.5	6055.1	–12.3
Corporate Pre-Tax Profits	296.9	299.3	318.5	304.1	304.7	–1.0	290.5*	295.0	305.0	315.0	301.4	-1.1
Net Profits	167.1	166.1	179.4	177.6	172.5	0.0	169.7*	172.3	178.2	184.0	176.1	2.1

*MH estimate

The stock market senses that better times lie ahead. The decline in interest rates and the expectation that this will lead to better sales and earnings have sent stocks soaring. From their lows of last October, the popular stock averages jumped more than 25 percent by April, before slipping a bit in May. This kind of rise in such a short period of time has never failed to signal the onset of an economic recovery within a few months. There's no mystery behind this; a rising stock market adds to the wealth, hence buying power, of those who invest, and confidence to investors and many others as well. Higher stock prices also enable companies to raise more equity capital, thus giving them more funds to spend, too.

Not surprisingly, the Government's index of leading economic indicators climbed in February and March, after falling nonstop during the previous six months. Its track record at predicting a pullout from recession is better than forecasting the onset of a decline, so if this index rises for another month or two, it would be an additional sign that the worst is over.

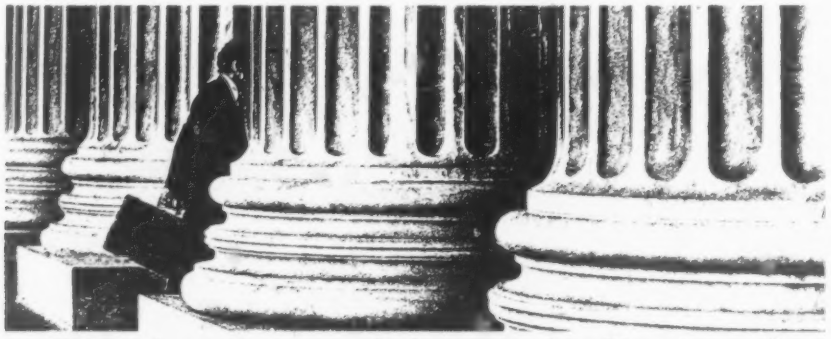
A Muted Recovery

Accordingly, the table to the left projects another decline in the gross national product adjusted for inflation during the current quarter—but at a much-reduced pace from that of the first. The expected upturn in aggregate economic activity should become visible on a quarterly basis starting in this year's third quarter, with a modest rise in the real GNP. However, to many, it will be difficult to distinguish between recession and recovery for several reasons. First, new jobs will not be readily available, since employers will not want to add to their staffs until they are sure the improvement in business is permanent. Also, learning from recent experience, many will try to keep their payrolls "lean and mean." Second, new peaks in overall spending are not likely to be reached until well into 1992, suggesting the need to keep a close watch on inventories and other costs of doing business, since weak demands will make it difficult for most companies to raise selling prices in order to boost profits.

The muted nature of this recovery contrasts with past rebounds, which have seen the real GNP jump by rates of nearly seven percent during the first year. Regardless of when they believe this recovery will get underway, practically all forecasters agree that it will be much slower than average. This is because, as noted in the April Economic Report, many of the causes of this recession are still present.

MANUFACTURERS HANOVER

Strength



In 1992 stringent new capital standards will go into effect throughout the banking industry worldwide.

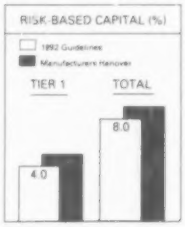
We exceeded these standards 2 years ago.

At year-end 1990, Manufacturers Hanover Corporation's primary capital totaled $6 billion, and our risk-based ratios placed us well above the new requirements established by the Basle Committee on Banking Regulations and Supervisory Practices.

Our ratios also placed us among the highest in our peer group of major money center banks.

Tumultuous times have necessitated the recognition of a primary yardstick for measuring the capital strength and overall health of our banking institutions. These new international standards are now providing that yardstick.

The focus on capital adequacy underscores the fact that the landscape of banking is changing. It also strongly suggests that only the best capitalized institutions will be able to take advantage of change and address their customers' evolving needs in an effective and timely fashion.



Using capital to measure the strength of a financial institution is hardly a new practice at Manufacturers Hanover. And while exceeding the new standards may be noteworthy, our aim is to continue building upon the sturdy financial foundation we already have in place.

© 1991 Manufacturers Hanover Trust Company

MANUFACTURERS HANOVER

Manufacturers Hanover Corporation
Bank Window, Church St. Station
New York, N.Y. 10015

First Class
U.S. Postage
PAID
Manufacturers
Hanover

00463000024182 C 528 CONGR0001
CONGRESSIONAL INFO SERVICE
ATTN SRI
4520 EAST-WEST HWY
BETESDA, MD 20814